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FEDERAL COMMUNICATIONS COMMISSION
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Before the
Federal Communications Commission
Washington, D.C. 20554

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In the Matter of:	)	
	)	
Federal-State Joint Board Recommended	)	CC Docket No. 96-45
Decision on Universal Service	)	

COMMENTS OF THE UNITED STATES TELEPHONE ASSOCIATION

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SUMMARY

The Joint Board's Recommended Decision does not adequately address the recovery of costs in a competitive marketplace. The current universal service system imposes an obligation to serve in return for the opportunity to recover the costs of service. So long as incumbent LECs have an obligation to provide service at a constrained price which entails making investments, regulators have the responsibility to assure the opportunity to recover that capital. The current system provides explicit and implicit support of approximately $21 billion. Over $20 billion in implicit support is provided through incumbent LEC prices for other services. Competition makes it impossible to sustain that implicit support and the Interconnection Order, if upheld, will eliminate incumbent LECs' abilities to use the contributions from prices charged to other services to support universal service. The Recommended Decision does not address either problem.

In addition, the Recommended Decision does not meet the requirements for universal service specified in the Act or even the additional principle of competitive neutrality adopted by the Joint Board. In particular, the Recommended Decision does not provide for an explicit, specific, predictable and sufficient support mechanism, does not ensure the competitively neutral application of the rules, does not recommend equitable and non-discriminatory contributions and does not ensure that customers will receive just, reasonable and affordable rates.

According to the Decision, the size of the universal service fund is determined by the difference between a national revenue benchmark, which is not specified in the Decision, and the cost of providing universal service as determined by a forward-looking cost proxy model, which

is not specified in the Decision. The revenue side of the equation includes revenues from access, toll and other discretionary services, despite the fact that the Act requires support to be explicit. The forward-looking cost proxy model is purely hypothetical and does not reflect the actual cost of providing universal service. By intentionally inflating revenues and understating costs, the Joint Board Decision will result in a fund which may be, at best, politically expedient in the short term, but which is neither sufficient nor explicit.

The size of the fund should be determined by subtracting the costs of providing universal service from universal service revenues. The purpose of the benchmark should be to determine the amount of support funded at the state and federal levels. The benchmark should be established as one percent of county median household income. Support from the federal funding mechanism should be provided for amounts which are above the benchmark.

USTA member companies are currently working on a "best of breed" proxy model which is utilizing the BCM 2 and the Cost Proxy Model to create an improved model which will more realistically reflect actual costs. The Hatfield Model Version 2.2.2 is fatally flawed and should not be used in its present form to quantify the subsidy to local exchange service to size a universal service fund. Universal service support should be based on actual, embedded costs that are regulated and unseparated. 100 percent of loop costs, 100 percent of transport costs assigned to local and switching costs, scaled to switch size, and including 100 percent of the line port costs should be included.

The recommendation that contributions be based on a carrier's gross income net of its payments to other carriers is not equitable and discriminates against incumbent LECs. This recommendation maintains the implicit subsidies found in current incumbent LEC rates and provides a competitive disadvantage to incumbent LEC competitors by relying on the incumbent LECs to provide service without recovery of the costs to provide service and to pay for it. In addition, this recommendation is unnecessarily complex. The use of retail revenues will provide a more equitable assessment of revenues and will be competitively neutral. Both inter- and intrastate retail revenues should be assessed. The jurisdictional nature of revenues is becoming less relevant. The costs of providing universal service are intrastate costs and the benefits of universal service funding will flow to the intrastate jurisdiction. Relying on interstate revenues only may create an undue burden on rural, high cost states.

There is no reason to reduce the current SLC cap if inter-and intrastate revenues are assessed. In fact, the recovery of common line costs should be accomplished in the most economically efficient manner possible. Reducing the current SLC cap would not meet that objective which has been pursued by both the Joint Board and the Commission. The Commission should adopt the Joint Board suggestion that incumbent LECs be permitted to recover CCL costs from interexchange carriers on a per-line basis and to deaverage those costs over a smaller geographic area.

Universal service contributions should be recovered through a customer surcharge to ensure that recovery is explicit, sufficient and predicable.

The Commission should specify the terms and conditions of eligibility to receive support to ensure competitive neutrality. Unless other carriers make the same commitment that incumbent LECs have, their provision of universal service will be an illusory promise. All telecommunications carriers should meet any requirements with respect to pricing, terms, conditions, provisioning and quality standards. All telecommunications carriers should be required to offer a stand-alone price for the universal service package. Further, the Commission should clarify under what circumstances resellers may be eligible for support as proposed by USTA in its comments.

Rural telecommunications carriers should receive the same amount of support during the transition that is currently received and should have an opportunity for adjustment under certain circumstances. The recommended calculation will not accomplish that goal. Freezing the amount of support will have severe, detrimental impact on these companies and their customers. Such a result is contrary to the Act and should not be permitted. USTA provides a calculation which will not penalize rural telephone companies or their customers. In addition, the Commission should permit all companies in Alaska and insular areas with less that two percent of the Nation's subscriber lines to be exempt from using the cost proxy model. Further, no rural carrier should be required to adopt a proxy which does not reflect its actual costs.

USTA also proposes that the definition of universal service include all lines to avoid unnecessary administrative burdens and that all carriers have an opportunity to disaggregate support to smaller geographic areas.

Finally, regarding the other support requirements, USTA does not believe that adequate consideration has been provided in the recommendation to support the significant changes in low income assistance. And, USTA strongly disagrees with the Joint Board's recommendation to include inside wire as a supported service for schools and libraries. The inclusion of inside wire goes far beyond Congress' intent and is contrary to current regulatory practice.

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COMMENTS OF THE UNITED STATES TELEPHONE ASSOCIATION

The United States Telephone Association (USTA) respectfully submits its comments on the Recommended Decision (Decision) of the Federal-State Joint Board (Joint Board) released November 8, 1996 in the above-referenced docket.[1] USTA is the principal trade association of the incumbent local exchange carrier (LEC) industry. Its member telephone companies provide over 95 percent of the incumbent LEC-provided access lines in the U.S. Incumbent LECs traditionally have been the sole providers of universal service. USTA will comment on the Joint Board Decision and provide the Commission with alternative recommendations, currently on the record, which comply with the statutory requirements and more appropriately balance the implementation of a competitive local exchange market with the preservation of high quality, affordable, universal service.

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[1]Public Notice, DA 96-1891, Common Carrier Bureau Seeks Comment on Universal Service Recommended Decision, CC Docket No. 96-45, released November 18, 1996.

I. THE RECOMMENDED DECISION DOES NOT ADEQUATELY ADDRESS THE RECOVERY OF COSTS IN A COMPETITIVE MARKETPLACE AND DOES NOT FULFILL THE REQUIREMENTS OF THE TELECOMMUNICATIONS ACT OF 1996.

The Joint Board was required to recommend changes to current Commission regulations in order to implement Sections 214(e) and 254 of the Telecommunications Act of 1996.[2] In addition to the multitude of competing interests and political considerations, the challenge before the Joint Board was enormous. As Congress properly recognized, the current universal service system cannot be maintained. The transition to a competitive marketplace, which was accelerating even before the 1996 Act with its pro-competitive provisions was signed into law, does not accommodate a universal service system implemented under a regulatory monopoly environment. However, as will be discussed herein, the 1996 Act requires that the goals of competition be balanced with the need to preserve and to increase universal service. Congress was very specific in setting forth the requirements for universal service. Unfortunately, the Recommended Decision did not address many of the important policy issues necessary to achieve that balance and, in many instances, does not even meet the specific requirements of the 1996 Act.

A. The Current Universal Service System Imposes an Obligation to Serve in Return for the Opportunity to Recover the Costs of Service.

Under the current system, universal service is achieved through a combination of Federal and state regulations which accomplish the following[3]:

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[2]Section 254(a)(1).

[3]See, generally, Lee Schmidt, Chairman, USTA, "The Universal Service Recommendation: Not Ready for Prime Time," before the National Association of Regulatory

1). Impose an obligation on incumbent LECs to provide high quality service at reasonable rates in a specified geographic area. In order to meet this obligation, incumbent LECs are required to invest in all areas, including those areas which are unattractive to serve at the constrained price, but to only charge prices allowed by regulation. As a result, incumbent LECs have built and maintained the public switched telephone network using the appropriate technology available. This network is serving as the platform for the development of a competitive telecommunications market.

2). Allocate costs among jurisdictions and among services which achieve politically acceptable prices, regardless of the actual costs of providing service. It is certainly no secret that decades of prior Commission and Joint Board decisions deliberately and systematically allocated costs to the interstate jurisdiction to keep local rates low. Cross subsidies, as will be discussed below, currently flow not only among the federal and state jurisdictions, but also among various, regulated incumbent LEC services. In general, business and urban users support residential and rural users. Long distance and value-added services support local service. These are the methods of support which traditionally have been used to establish and maintain universal service.

3). Average rates throughout a study area to ensure acceptable prices. Rate averaging within a study area prevents recognition of the differences in costs to serve high density and low density areas.

4). Support incumbent LECs with higher than average costs compared to nationwide average costs through a high cost fund.

5). Provide relief for economically disadvantaged customers through the Lifeline and Link up programs.

So long as incumbent LECs have an obligation to provide service at a constrained price which entails making capital investments, regulators have a responsibility to assure the opportunity to recover that capital. "It would breach the regulatory contract for the regulator to make unilateral changes in regulation that might prevent a utility from recovering the economic costs of investments that it made to discharge its regulatory obligations to serve. Contractual protections of the interests of the utility and its investors exist so that the state and private

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Utility Commissioners, Annual Convention, November 19, 1996.

companies can continue to make agreements requiring investments in highly specialized capital."[4]

The current universal service system of support currently provides explicit and implicit subsidies of approximately $21 billion a year to promote and maintain universal service at reasonable rates. The current high cost, Lifeline and Link-up programs provide about $1 billion in explicit support.[5] The remaining $20 billion is provided primarily by incumbent LECs from other services, such as toll and access services.[6] Vertical and business services also contribute to

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[4]J. Gregory Sidak and Daniel F. Spulber, "Deregulatory Takings and Breach of the Regulatory Contract," 71 New York Univ. Law Rev. 851,884 (October 1996). Sidak and Spulber explain the regulatory contract as follows. "Regulators protect the utility's opportunity to earn a competitive return by controlling entry into its market, restrict the maximum earnings of the utility through rate setting, and establish service requirements through universal service, carrier of last resort and other rules. That arrangement, known as the *regulatory contract*, enabled the regulators to reconcile their ceilings on the earnings of utilities with the requirement that, in terms of actuarially expected value, prospective investors be offered a competitive rate of return on their investments. Without the expectation of earning a competitive rate of return, investors would not be willing to commit funds for the establishment and operation of the utility. The funds are committed to provide services to the customers of the regulated utility. Once the utility invests those funds, the long depreciation schedules typical in electricity and telecommunications regulation credibly commit the utility to performing its obligations under the regulatory contract by denying it the opportunity to recover its capital before the end of its useful life... In the absence of contract enforcement, the utility is at the mercy of the regulatory authority: by lowering rates to levels that do not allow a full recovery of costs, after the facilities have been created, a regulator could take advantage of the utility and its investors...The opening of the telecommunications or electricity markets to competition provides a temptation for regulators to behave in an opportunistic manner. The utilities have already constructed their network facilities. They will keep those facilities in operation as long as revenues cover their operating costs, even if revenues are not sufficient to allow even partial recovery of capital costs...". Sidak and Spulber at 857, 887 and 885.

[5]USTA Comments, CC Docket No. 80-286, October 28, 1994.

[6]Calvin S. Monson and Jeffrey H. Rohlfs, "The $20 Billion Impact of Local Competition in Telecommunications", July 16, 1993; USTA Comments, CC Docket No. 80-286, October 28, 1994; and USTA Ex Parte, CC Docket No. 80-286, February 9, 1995.

this amount. In fact, incumbent LECs have invested over $280 billion to build the current public switched network which includes over 150 million access lines and has achieved a nationwide penetration level of 94 percent.[7] This network benefits all customers, not just those of incumbent LECs.

Competition affects all incumbent LECs' abilities to maintain universal service, whether they receive support for high cost areas or local services or generate support from low cost areas or high contribution services. In a competitive marketplace, prices are driven toward economic costs.[8] Market participants who cannot or will not move their prices toward economic costs will lose market share and profitability over time. Regulatory policies that do not promote or even allow economic pricing are not competitively-neutral. Current incumbent LEC prices which provide support for universal service provide a wide umbrella under which competitors can set prices and attract high volume customers. As these customers are lost to competitors, the burden on the incumbent LECs and their remaining low volume customers to maintain universal service is increased significantly. This situation has been exacerbated by the Commission's Order implementing the local competition provisions of the 1996 Act.[9]

The Interconnection Order eliminated the incumbent LECs' ability to support universal service with usage-based access, toll and vertical service revenues. The Order required incumbent LECs to wholesale both their services and parts of their network to competitors at

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[7]USTA Ex Parte, CC Docket No. 80-286, February 9, 1995.

[8]Prices which reflect economic costs are not TELRIC-based prices.

[9]Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, August 8, 1996. [Interconnection Order].

prices which in many instances are substantially below cost. This includes both interstate and intrastate services as well as network elements used to provide both interstate and intrastate services. It also allowed interconnecting competitors to evade exchange access charges through the purchase of unbundled network elements. By July 1997, the Carrier Common Line (CCL) Charge and the portion of the Residual Interconnection Charge currently permitted are to be completely eliminated. Vertical services were defined as part of the unbundled switching element, effectively eliminating those revenues from supporting universal service.

The arbitrage among access and local interconnection and unbundled network elements permitted under the Interconnection Order will quickly erode the traditional sources of revenues used to support universal service. Competitors will continue to cream skim the highest revenue producing customers in the lowest cost geographic areas on an unbundled basis and resell services to the rest. As incumbent LECs lose these customers, the LECs' average costs per customer will rise and their revenues per remaining customer will decline as revenues from other services are lost. This effect will be magnified because many (if not most) of the customers LECs will "lose" will still be served by LECs on a wholesale basis through unbundled network elements. The prices mandated in the Order for these elements are such that LECs will not receive sufficient revenues to cover the costs of serving customers. Thus, previously "subsidizing" customers will become "subsidized" customers.

The Interconnection Order is currently on appeal in the U. S. Court of Appeals for the 8th Circuit.[10] Unless overturned, the Order will require incumbent LECs to provide services that are

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[10]Iowa Utilities Board v. FCC, No. 96-3321. The Court granted a stay of the pricing and "pick and choose" rules contained in the Interconnection Order on October 15, 1996 pending its

currently subsidized at rates that do not cover their costs. Contributions from prices charged for other services which have been used to support universal service by covering the costs of providing local service will no longer be available. The Decision of the Joint Board is remiss in ensuring the recovery of costs of providing universal service and in recognizing the impact of competition and the Interconnection Order on the maintenance of universal service. In balancing the often conflicting interests of competition and the preservation of universal service, the Joint Board cannot simply ignore the obligations imposed on incumbent LECs and the investments and responsibilities which incumbent LECs have undertaken to meet those obligations. Any effort to reform universal service policies must, at the very least, take into consideration what currently exists. The Commission's final decision must focus on this glaring omission and address it in a manner which does not increase the risks facing incumbent LECs.

B. The 1996 Act Clearly Specifies the Requirements for Universal Service.

The Joint Board was required to recommend changes to the Commission's regulations based on a specific list of principles contained in the Act to ensure that quality services would be available at just, reasonable and affordable rates; access to advanced telecommunications and information services would be provided in all regions of the Nation; customers in rural and high cost areas would have access to telecommunications and information services, including interexchange and advanced telecommunications services, that are reasonably comparable to services and rates in urban areas; all telecommunications providers would make an equitable and

final decision in this case.

nondiscriminatory contribution to preserve and advance universal service; specific, predictable and sufficient Federal and state mechanisms would be available; and elementary and secondary schools and classrooms, health care providers and libraries would have access to advanced telecommunications services.[11] The Joint Board added another laudable principle: that universal service support mechanisms and rules would be applied in a competitively neutral manner.[12] In addition, the Act requires that any universal service support be explicit.[13] Further, the Joint Board was required to recommend a plan for providing telecommunications services for health care providers in rural areas and educational providers and libraries.[14]

Consistent with the objectives of the 1996 Act to open telecommunications markets to competitive entry, to promote universal service and to reduce the need for government regulation, the Joint Board should have attempted to meet the requirements specified in the Act in a manner which balances the transition to competition with the need to preserve universal service. Unfortunately, the Decision is silent on important issues such as the amount of high cost support and determining the costs of providing universal service. Other recommendations are deficient in meeting the principles of the Act. In particular, as will be discussed below, the Decision does not provide for an explicit, specific, predictable and sufficient support mechanism, does not ensure the competitively neutral application of the rules, does not recommend equitable and nondiscriminatory contributions to the support mechanisms and does not ensure that

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[11]Section 254(b).

[12]Recommended Decision at ¶ 23.

[13]Section 254(e).

[14]Section 254(h).

customers will receive just, reasonable and affordable rates. Those portions of the Recommended Decision which do not comport with the Act must be rejected.

II. THE UNIVERSAL SUPPORT MECHANISM MUST BE EXPLICIT, SPECIFIC, PREDICTABLE AND SUFFICIENT.

The 1996 Act requires that universal service support mechanisms at both the state and Federal levels be explicit, specific, predictable and sufficient. The Recommended Decision does not address the size of the fund necessary to provide high cost universal service support at levels which are explicit, specific, predictable and sufficient. As explained above, the current system provides approximately $21 billion in explicit and implicit support to make universal service available at today's prices. The vast majority of that amount is implicit in incumbent LEC rates for other services. The Joint Board decision by maintaining implicit subsidies and understating the actual costs of providing universal service fails to meet the requirements of the Act.

The size of the fund is determined by the difference between a national revenue benchmark, which is not specified in the Decision, and the cost of providing universal service as determined by a forward-looking proxy cost model, which is not specified in the Decision. The revenue side of the equation includes revenues from access and other discretionary services, much like the current system, despite the fact that the Act requires support to be explicit. The forward-looking proxy cost model is purely hypothetical and does not reflect the actual cost of providing service. By intentionally inflating revenues and understating costs, the Joint Board Decision will result in a fund which may be, at best, politically expedient in the short term, but which is neither sufficient nor explicit.

In order to meet the requirements of the Act, the universal service support mechanism should replace current explicit mechanisms such as the current universal service fund and long term support. The subsidies implicit in interstate prices, including CCL charges, weighted Dial Equipment Minutes (DEM) and averaged end user subscriber line (EUCL) charges and the subsidies implicit in intrastate prices, including vertical service prices, business line prices, intraLATA toll prices and switched access prices, should also be replaced on a dollar for dollar basis with a combination of price rebalancing and an explicit universal service fund sufficient to ensure that universal service is maintained with affordable rates for all customers. In fact, price rebalancing will reduce the size of the fund in a competitively-neutral manner.

The amount of support should be determined by the difference between universal service costs for a specified area and universal service revenues. A national funding index (benchmark) would be established to identify the universal service costs to be funded at the federal and state levels. Costs above the index would be recovered through the federal fund created by the Joint Board. Remaining costs above current rates would be the responsibility of the states. USTA's plan to meet the requirements of the Act is included in its October 3, 1996 Ex Parte filing.

A. The Benchmark Should Not Perpetuate Implicit Support of Universal Service.

While USTA has consistently proposed that a nationwide benchmark be used in calculating the amount of support eligible telecommunications carriers would receive from the federal universal service fund, as was recommended by the Joint Board, USTA strongly opposes a benchmark based on nationwide average revenue per line in which revenues from local exchange, discretionary and access services are included.[15] Such a recommendation only serves to maintain the implicit support of the current system which is incompatible with a competitive marketplace and which is contrary to the statutory requirement that support be explicit. As noted above, such revenues will no longer be available to support universal service as competitors with no regulatory constraints continue to target high volume customers. Including revenues from access and discretionary services will create a mismatch since the costs of such services would not be included in the determination of universal service costs.

The purpose of the benchmark should be simply to identify the amount of support to be funded at the federal and state levels. USTA proposed that a residence benchmark be established as one percent of county median household income and that the business benchmark be set at 1.5 times the residence amount. The use of median household income is appropriate because it reflects what customers reasonably can expect to pay for service. Setting the benchmark at a county level will permit the benchmark to better reflect local calling areas and the pertinent community of interest which the Joint Board acknowledges are important indicators of affordability. A floor and ceiling amount should be set to reflect the current nationwide average rate, to provide an opportunity to identify the need for Lifeline assistance and to smooth the potential for extreme results using median income at the county level.

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[15]Recommended Decision at ¶ 310.

B. The Costs of Providing Universal Service Must Include the Actual Cost of Providing Universal Service.

The proper determination of the cost of providing universal service is the actual cost the incumbent LEC incurs to provide universal service. A proxy cost model can be useful in identifying high cost areas, but such models, particularly those which are based on forward-looking costs as recommended in the Joint Board decision, were never intended to determine the cost of providing service.

Proxy models based on forward-looking costs are, by definition, hypothetical. "In a typical proxy model, workers are always healthy, equipment always functions and all residences and businesses are exactly alike and efficiently located. Not surprisingly, the costs of a hypothetical network may not bear a strong resemblance to actual costs."[16]

Forward-looking cost proxy models also disregard costs imposed by regulatory obligations. Basing support solely on the difference between hypothetical costs and nationwide average revenues will prevent incumbent LECs from recovering the embedded costs of past and current obligations which the regulatory contract promised an opportunity to recover. Recovery of such costs must be permitted if regulators continue to require that such costs continue to be incurred. Otherwise, such actions constitute a regulatory takings because incumbent LECs assumed obligations to serve, including the provision of universal service, in return for the regulator's assurance that the utilities would have the opportunity to earn a competitive return on invested capital, along with the compensation for the full cost of providing service.[17]

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[16]Schmidt at 2.

[17]Sidak and Spulber at 857.

Further, the use of hypothetical costs cannot guarantee that the fund will be sufficient as required by the statute. Since it does not reflect the real costs of providing universal service, there is no way for the regulator to know if the funding will preserve and maintain current universal service, much less to provide the necessary support to ensure that service is of the highest quality, an obligation which has been met by incumbent LECs, or the necessary infrastructure to support advanced services.

Understating the costs of providing universal service through the use of a hypothetical proxy cost model could have some additional, unintended results. First, if the costs are too low, the current implicit support will perpetuate the uneconomic prices which currently exist, thereby violating the statutory mandate that support be explicit and preventing the development of a truly competitive market. Second, if the costs are too low, facilities-based competitors will have no incentive to enter these markets, thereby violating the expressed intent of the Act. Third, if the costs are too low, the ability of rural carriers to maintain the infrastructure necessary for the provision of universal service at rates that are comparable to urban rates will be seriously undermined.

It is possible to develop a proxy cost model that more closely reflects the actual costs of providing universal service. The Joint Board indicates that the Benchmark Cost Model (BCM) 2 and the Hatfield Model 2.2.2 are the best models available for future development of an acceptable proxy model.[18] As will be discussed below, in an October 16, 1996 ex parte filing, USTA provided an analysis of the Hatfield model which shows that it is wholly inappropriate

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[18]Recommended Decision at ¶ 279.

and should not be used.[19] USTA member companies are currently working on the development of a "best of breed" model which is utilizing the BCM 2 and the Cost Proxy Model to create an improved model which will more realistically reflect actual costs.

According to the analysis performed by Dr. William E. Taylor of the National Economic Research Associates, Inc. and confirmed by many other economists, the Hatfield Model Version 2.2.2 is fundamentally flawed and should not be used in its present form as the basis for setting prices for interconnection or unbundled network elements or for quantifying the subsidy to local exchange service to size a universal service fund.[20] As some state regulators have found, it deviates from actual costs to such an extent "that the model can't be taken seriously at this time without detrimental effects on the current providers of telephone service."[21]

As proposed by USTA in its October 3 Ex Parte, universal service support should be based upon actual, embedded costs that are regulated and unseparated. The types of costs to be recovered through universal service should include 100 percent of loop costs, 100 percent of transport costs assigned to local (this would not include access or toll transport) and switching costs, including 100 percent of the line port costs, scaled to switch size as follows:

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[19]It should be noted, however, that with the proper inputs and assumptions, even the Hatfield model could render reasonable results.

[20]William E. Taylor, "Not the Real McCoy: A Compendium of Problems with the Hatfield Model", USTA Ex Parte Filing, October 16, 1996.

[21]Joel Shifman and Ron Choura, "Existing Proxy Models: What Can They Be Used For?", September 1996.

Switch Size	Costs Recovered Through Universal Service
1- 500 lines	90 percent of total switching costs
501 - 5,000 lines	80 percent of total switching costs
Over 5,000 lines	70 percent of total switching costs

III. THE FUNDING BASE FOR UNIVERSAL SERVICE SUPPORT MECHANISMS MUST BE COMPETITIVELY NEUTRAL.

USTA agrees with the Joint Board recommendation that the statutory requirement that all carriers providing interstate telecommunications services must contribute to universal service support mechanisms be broadly construed.[22] Such a requirement will ensure competitive-neutrality by expanding the funding base in an equitable and non-discriminatory manner. However, the recommendation that contributions be based on a carrier's gross income net of its payments to other carriers is not equitable and discriminates against incumbent LECs. This recommendation maintains the implicit subsidies found in current incumbent LEC rates and provides a competitive advantage to incumbent LEC competitors by relying on the incumbent LECs to provide universal service without recovery of the costs of providing it and to pay for it.

A. Universal Service Funding Should be Based on Retail Revenues to Ensure that it is Equitable and Non-Discriminatory.

The recommendation that universal service contributions be based on a carrier's gross telecommunications revenues net of its payments to other carriers is contrary to the Act's

[22]Recommended Decision at ¶ 784.

requirement that contributions be equitable and non-discriminatory. Incumbent LECs provide the transport services that other carriers will be permitted to exclude payments for under this recommendation. This means that incumbent LECs will be contributing far more than any other telecommunications service providers into the fund. Such a burden on incumbent LECs can only mean that the implicit subsidies of the current system must be continued.

In addition, the Joint Board proposal will add unneeded complexity to the administration of the funding mechanism. Given the manner in which the market is evolving, with the availability of unbundled network elements and resale opportunities, the number of carriers involved in the provision of service will only increase. It will become even more difficult to track and verify payments to other carriers. The opportunities to evade the statutory requirements to contribute will increase accordingly. An assessment based on retail revenues avoids such difficulties.

The use of retail revenues will provide a more equitable assessment of all telecommunications carrier revenues and thus, will be competitively neutral. It is also administratively simple and will result in a fund that is specific, predictable and sufficient. Retail revenues have been used successfully in several states as the basis for determining contributions to universal service funding.[23] USTA urges the Commission not to adopt the Joint Board recommendation as discussed above.

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[23]See, 30 V.S.A. § 7521(a).

<u>B. Both Inter- and Intrastate Retail Revenues Should Be Assessed to Fund Universal Service.</u>

The Joint Board recommended that the Commission seek further comment on whether both inter- and intrastate revenues should be assessed to fund universal service. USTA agrees that federal and state universal service mechanisms should be complementary. In fact, states should be provided with guidelines to enable them to make up the difference, if any, between revenue from local rates and revenue at the level of the benchmark through a combination of rate rebalancing or state universal service fund. However, USTA believes that the funding base should include both inter- and intrastate retail revenues.[24]

Given that, over time, the jurisdictional nature of revenues will become less relevant, it may not be practical or necessary to require that the funding base be determined by jurisdiction. The majority of the costs of providing universal service for purposes of establishing the federal portion of the fund are intrastate costs. Thus, the benefits of universal service funds will flow to the intrastate jurisdiction. Using both inter- and intrastate revenues as the funding base will eliminate gaming by carriers seeking to avoid contributing in both jurisdictions. A larger funding base will reduce the size of the surcharge needed to recover the contributions.

A mechanism that would rely solely on interstate revenues to fund the federal support mechanism and intrastate revenues to fund state support mechanisms would also create an undue burden on rural, high cost states, particularly if the benchmark is set too high in order to reduce

[24]While the statute specifies that only the providers of interstate services be required to contribute, the Commission should define a provider of interstate services to be any carrier that originates or terminates an interstate call.